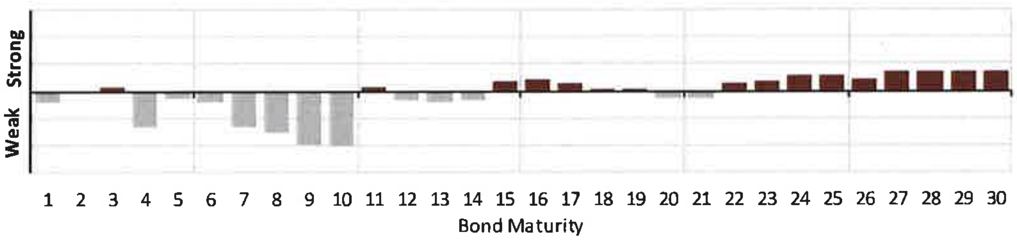
MMA The Power of Independence

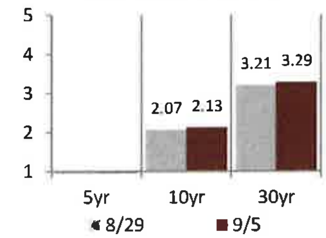
SEPTEMBER 8, 2014

MUNICIPAL ISSUER BRIEF

Strong or Weak Market for Bond Sellers



Muni Bond Rates (%)



Heading into this week, selling pressure in the shorter part of the yield curve put that part of the market into a weaker dynamic for new-issues while the longer end is presenting mild pricing opportunities for issuers.

MARKET UPDATE

AUGUST ENDS STRONGLY BUT SEPTEMBER STARTS WITH DIFFICULTY: Our two-week hiatus made for a story of two markets with last month finishing an impressive rally but a historically strong September sputtered at the start.

INVESTORS & ISSUERS: Two rate directions but similar themes.

- The lack of issuance continues to drive the market this summer and the last two weeks **did not deviate with well-below historical averages coming to market.**
- Still, the first week of this month saw yields jump under pressure from **U.S. Treasury bonds that began to cheapen** with a growing consensus that the broader U.S. economy is improving.
- That consensus **took a turn south on Friday last week** when monthly job creation data fell well short of expectations and bond markets began to improve.
- Even with the negative rate pressure, most municipal issuers did very well largely because of the lack of supply this summer.
- Of note the higher-rated competitive deals continued to see large bank interest and have been able to successfully offer low coupons farther along the curve. **The Florida Board of Education last week and the Virginia Public Building Authority that sold at the end of August were the latest beneficiaries of this theme.**
- One interesting point in the secondary market was **a large asset management firm that sold nearly $425 million over a 2-week span through bids-wanted lists**. The lists consisted of double-A or better bonds in the 5- to 10-year range. Increased bids-wanted par often negatively affects new-issue pricings as buyer attention moves away from the primary and into the secondary market—this was not the case last week. Summer's secondary selling activity was very light, especially in August, **Figure 1**.
- Meanwhile, **Congress returns this week after a 5-week summer recess**, though there are only about 7 sessions before they break again for the mid-term election recess. Regulators, however, have not taken a break. The new bank liquidity rules and their effects on municipals are examined on **page 3**.

BUYERS BITES:

WHAT IS TRENDING HOT:

1) Lower but still investment grade healthcare, airports
2) AMT airports
3) California Community College Districts

CURRENTLY HARDER SELLS:

1) New Jersey GO and appropriation-backed
2) Higher-rated bonds in the 2- to 8-year range

WHO IS REPORTEDLY BUYING:

Large banks, investment-grade and high-yield mutual funds, separately managed accounts (SMAs)

Secondary Selling Pressure Averages		
Period	BW Par ($Million)	Offering Par ($Million)
Since June, 2008	$557	$11,411
60-day	$470	$12,665
20-day	$405	$12,453
5-day	$392	$11,226

***Figure 1**: Above shows the average amount of daily bids-wanted par and dealer offering amounts. Note the decline in bids-wanted in August (highlighted 5-day average specifically). This means that bond investors have become much less inclined to sell their municipal holdings, which is a positive dynamic for issuers selling bonds near-term.*

MMA TO HOST ISSUER-FOCUSED WEBINAR TOMORROW at 4pm ET (3CT and 1PT): MMA is pleased to hold a **FREE** webinar to help issuers understand the current dynamics in the municipal industry. The webinar's intent is to provide information to improve the dialogue between issuers and their advisors, bankers, underwriters and investors. Government officials who have issued debt, or are considering a bond sale in the remainder of 2014, will find the webinar especially useful for planning purposes. **The webinar is for issuers only and its purpose is for market information and educational purposes only.**

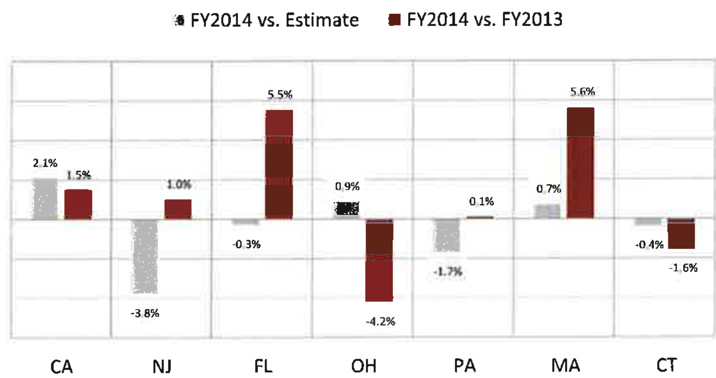
Reserve your Webinar seat now here.

TOPIC OF THE WEEK: THE IMPORTANCE OF STATE REVENUE PROJECTIONS

STATE REVENUE PROJECTIONS: With the passing of fiscal year 2014 on June 30th for most states, several public policy think tanks hit the headlines with state revenue reports. Much of the focus is on year-over-year performance. This is an important indicator that rating agencies, investors and other market participants track, but there is another item that at times is largely missed: **how actual tax collections compare to estimates**. **MMA** reviewed the budget to actual revenue performance of 7 larger states (NJ, PA, CT, FL, CA, MA and OH), excluding NY and TX that have different fiscal cycles, and IL, which has yet to report. Our analysis indicated that actual state revenues were generally flat -0.1%, while year-over-year performance was up 1.2%. Among the winners, CA, MA and OH reported actual revenues above their conservative projections. On the other side, NJ, PA, CT and FL saw revenues come in below forecasts, despite these states having outperformed FY2013's actual performance. **The takeaway here is that the estimates in these states were overly aggressive, possibly to use revenue to "balance" the budget while spending more in the interim.**

Using NJ as an example, the state collected $27.5 billion in FY2013, estimated at budget adoption that tax revenues would grow 5%, or about $1.4 billion in FY2014. However, actual FY2014 revenues only grew 1% or $281 million, making for a shortfall of about $1 billion. Drilling further into the causes, **MMA** found that NJ's gross income tax collections, which totaled $12.1 billion, or 6.3% below the $13 billion estimate, drove much of the shortfall. The State Treasurer office released a press release on August 14, 2014, noting that revenues came in 1% above the prior year, although they neglected to note the 3.8% decline versus estimate (**MMA**'s views this comparison as the critical element).

2014 Fiscal Year Revenues Compared to Estimates and 2013



WHAT IT MEANS FOR YOU: Whether a state makes its revenue target is of the utmost importance to credit analysts evaluating whether to invest in the state, and to a certain extent, the localities within that state. Revenue performance can indicate whether shortfalls (or surpluses) are in the future, possibly meaning painful budget cuts and even rating downgrades. Despite the ongoing importance to both credit analysts and policymakers, most states fail to provide public monthly revenues-versus-budget reports and many of those that do, only report on a year-to-year basis, which is less meaningful. This type of transparency is something that state financial officials closely track but often don't report publicly. **MMA** expects more pressure will encourage officials to report the information, and in turn, that will help issuers better access capital markets.

Future editions of ***MIB*** will report trends in revenue collections as they are released. While this information might be considered sensitive by some leaders, the data that is collected by every state should be uniformly reported so that stakeholders can anticipate available resources, allocate portfolios and plan accordingly.

NEW BANK RULES FOR MUNICIPAL BONDS

MUNICIPALS NOT INCLUDED IN HQLA: Last week, the Federal Reserve released its highly anticipated final commentary on high-quality liquid asset (HQLA) requirements for large banks in its proposed liquidity coverage ratios in which municipal bonds were not deemed HQLA. However, the staff recommended further review of the asset class to determine whether parts of the municipal market are in fact HQLA. **In essence, this looks to be the start of the process of bifurcating the market into highly liquid (most likely larger, more frequent issuers, state GOs etc.) and those that are not.** Also, it is noteworthy that **4 banks hold $100 billion of the total $400 billion in bank portfolios.** The decision comes after several state and local government issuer groups sent letters to the Fed urging municipals to be included in the HQLA designation. **Still, MMA expects there will be little effect on near-term market prices.** Exclusion of municipals as HQLA does not mean large banks will sell their bonds or halt municipal portfolio growth immediately. Rather, it implies that, in times of severe systemic crisis—when banks' liquidity coverage ratios are approaching regulatory minimums—they will shy away from buying, or making markets in, municipals. **For a full review on HQLA's market impact, see MIB from June 2.**

REGIONAL BOND ISSUES (Moody's/S&P/Fitch)

NORTHEAST

On September 3rd, **Roosevelt & Cross Inc.** priced $22 million of revenue bonds for **Montgomery County, NY**; Aa3/NR/NR; callable in 9/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	4.00	1.37	+43
2024	5.00	2.62	+54
2034	4.00	3.65	+67

Notes: MAC insurance tightened spreads to MMA 5% Benchmark

MID-ATLANTIC

On August 27th, the **Virginia Public Building Authority** sold $438 million of public facilities revenue bonds to **Bank of America Merrill Lynch**; Aa1/AA+/AA+; callable in 8/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.21	+26
2024	5.00	2.27	+16
2034	4.00	3.26	+24

Notes: This deal had 5 bidders with big cover bids

MIDWEST

On August 27th, **Citigroup** priced $1.8 billion of Detroit Water and Sewerage Department bonds for the **Michigan Finance Authority** in several series, some insured; Ba2/BBB+/BBB-; callable in 7/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	2.25	+97
2023	5.00	3.24	+129
2037	5.00	4.52	+139

Notes: Bonds traded strongly in the secondary market post-issuance

SOUTHEAST

On September 3rd, the **Florida Board of Education** sold $214 million of public education capital outlay refunding bonds to **JPMorgan Securities LLC** ; Aa1/AAA/AAA; callable at par in 6/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.12	+18
2024	5.00	2.22	+14
2034	4.00	3.26	+28

Notes: A large amount of the bonds were sold in presale

SOUTHWEST

On September 3rd, **FirstSouthwest** priced $100 million of unlimited tax school building bonds for **La Porte Independent School District, Texas**; Aa2/AA/NR; callable in 8/15/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.07	+13
2024	5.00	2.26	+18
2034	4.00	3.36	+38

Notes: +38 to 4% coupons on 20-year bonds helped demand

FARWEST

On September 3rd, **JPMorgan Securities LLC.** priced $78 million of state capital project bonds for the **Alaska Housing Finance Corporation**; NR/AA+/AA+; callable in 12/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.40	+46
2024	5.00	2.55	+47
2029	5.00	3.03	+39

Notes: An infrequent issuer, the corporation found support